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UNCLAS SECTION 01 OF 04 PRETORIA 004855

SIPDIS

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TAGS: EINV ETRD EFIN ECON USTR SF
SUBJECT: SOUTH AFRICA: BEE CODES OF GOOD PRACTICE
CODE 100: OWNERSHIP

REF: PRETORIA 4854

¶1. (U) Summary. On November 1, the Department of Trade and Industry (DTI) released the final version of the Broad-based Black Economic Empowerment (BEE) Code on Ownership, i.e., Code 100. One of ten codes, Code 100 sets forth the criteria and methodology for scoring compliance with BEE objectives in the ownership of an entity. This portion of the BEE Generic Scorecard accounts for 20% of a firm's total score. In each instance, the actual number of points awarded is calculated by multiplying the fraction of a BEE target (there are seven) achieved by the number of possible points allotted for each target. No excess scoring for exceeding any BEE target is possible. However, up to three percentage points may be earned for meeting a bonus target. End Summary

¶2. (U) This is the second in a series of cables reporting on the final criteria and methodology for scoring BEE contribution as embodied in the government's BEE Codes of Good Practice. After nine months of consultations, the Department of Trade and Industry released its final version of the Broad-based Black Economic Empowerment (BEE) Code on Ownership (Code 100) on November 1. The stated goal of Code 100 is to provide incentives for black ownership in the South African economy. The code contains a number of complex formulas to be used in the calculation of a black ownership score. All BEE Codes of Good Practice, including this one, may be found at the following Internet website:

http://www.dti.gov.za/bee/CODESOFGOODPRACTICE 2005.htm

The Ownership Score

¶3. (U) The portion of the BEE generic scorecard covered by Code 100 accounts for 20% of a firm's total score. Firms may earn a bonus of three percentage points for ownership by new black entrants or broad based black ownership schemes (such as pension and mutual funds, or employee options). For a complete understanding as to how this portion of the generic scorecard factors into the rest of the scorecard, please refer to Ref A.

¶4. (U) The ownership score (Code 100) focuses on the following three components:

-- Control of the firm by black people through exercisable voting rights;

-- The entitlement of black people to economic interest in the form of dividends, capital gains, and other shareholder rights;

-- Net equity held by black shareholders, calculated by deducting the cost of any debt financing of a share purchase from the total value of shares held.

¶5. (U) Firms may earn up to 14 points if black people control at least 25% of the voting rights, economic interest, and net equity of a firm. Firms may earn another 4 points if black women hold 10% of the voting rights, economic interest, and net equity of a firm. Firms may earn an additional 4 points for having new black owners or broad based black ownership (such as may be provided through pension and mutual funds, or employee options), of which three will be bonus points. Black ownership in pension and mutual funds may be determined by the percentage of black ownership multiplied by the value of the fund, or by a proportional formula. Black ownership of employee options may be determined by the value of the options owned by blacks, or by the exercisable voting rights afforded to blacks. Therefore, although ownership counts for 20 points on the generic scorecard, a firm could score a 23 points if it qualified for the bonus. The following table represents the criteria, points, and targets for deriving a score for ownership:

Criteria	Points	Target
Exercisable Voting Rights:		
Black People	3	25% + 1 vote
Black Women	2	10%
Economic Interest:		
Black People	4	25%
Black Women	2	10%
Black Designated Groups	1	2.5%
Realization:		
Net Equity Ownership	7	10% year 1 20% year 2 40% year 3 60% year 5 80% year 7 100% year 9
Ownership Fulfillment	1	Only for a score of 7 points on Net Equity Ownership
Bonus:	3	
Economic Interest:		
New black entrants or BEE ownership schemes		15% and
Black People		25%

Scoring

¶6. (U) In each case (except Ownership Fulfillment), the actual number of points awarded is calculated by multiplying the fraction of the compliance target achieved by the number of possible points in each category. For example, if 12.5% of the exercisable voting rights are controlled by blacks, then 12.5% is divided by the compliance target of 25%. Instead of scoring the maximum three points, the firm would score

only 1.5 points for that category. Anything over 25% would still only result in a maximum of 3 points. For example, if 50% of the exercisable voting rights were controlled by blacks, the entity would still only score 3 points instead of 6 points.

¶7. (U) Code 100 also outlines a number of measurement principles that provide options to firms in measuring black ownership. These are presented below.

The Flow-Through Principle

¶8. (U) Using the Flow-Through Principle, a firm may calculate black ownership interest through several tiers of an ownership chain simply by multiplying the percentages of black ownership at each tier. For example, if 50% of Firm A is black owned and Firm A owns 50% of Firm B, then the resulting level of black ownership in Firm B would be 25%. Ownership chains may involve many more than two tiers, but the calculation is essentially the same.

The Modified Flow-Through Principle

¶9. (U) The Modified Flow-Through Principle functions in the same manner as the Flow-Through Principle, except that participating firms are entitled to choose which black majority owned company they will treat as if 100% black owned. This encourages black majority ownership in firms and yields a more favorable result for the measured firm. For example, if 51% of Firm A is black owned and Firm A owns 50% of Firm B, then the resulting level of black ownership in Firm B would be 50% because Firm A would be treated as if it were 100% black owned. Again, ownership chains may involve many more than two tiers, but the calculation is essentially the same.

The Control Principle

¶10. (U) The Control Principle allows a measured firm to

treat each black majority controlled company along an ownership chain as if it were 100% black owned for calculation purposes using the Flow-Through Principle. Black majority control is defined as blacks holding more than 50% of the exercisable voting rights of an enterprise. This can yield a much more favorable result than the Modified Flow-Through Principle. For example, if Firm A is black controlled, and Firm A controls 51% of Firm B, then the resulting level of black ownership in Firm B would be 100% because Firm B would be treated as if it were 100% black owned. Again, ownership chains may involve many more than two tiers, but the calculation is essentially the same.

The Exclusion Principle

¶11. (U) The Exclusion Principle allows for any ownership by an organ of state or a state enterprise to be excluded from the ownership calculation. This means that a firm with a government entity as a shareholder will not be rewarded -- nor penalized -- for government ownership.

Sale of Assets

¶12. (U) Sub-Code 101 provides an alternative avenue for a firm to measure its contribution towards black ownership through the sale or creation of a sustainable business or assets to/for blacks. The ownership value of such a BEE enterprise to a measured firm is calculated by dividing

the present value of the BEE enterprise by the present value of the firm on the date of measurement. For example, if the BEE enterprise represents 10% of a firm's assets, the firm can recognize the equivalent of 10% black ownership. If the BEE enterprise grows faster than the firm, it will be able to recognize an increasing level of black ownership in successive years. In this way, a measured firm is encouraged to ensure the sustainability of the BEE enterprises it spawns, and to develop and expand these enterprises over time. However, the benefit does not flow through to subsidiaries, nor can it be again counted under the enterprise development segment of the generic scorecard.

Preference Shares and Debt

¶13. (U) Preference shares that behave like debt and debt components of hybrid equity instruments are to be treated like debt in the calculation of black ownership.

Definitions

¶14. (U) Black is defined as black (i.e., African), "coloured," and Indian South Africa citizens (or those who could have applied for South African citizenship, if permitted) who suffered discrimination under the apartheid regime, and their descendents.

¶15. (U) An Exercisable Voting Right is a voting right that is not subject to any limitation.

¶16. (U) Economic Interest is represented by the entitlement to a return on ownership, such as a dividend.

¶17. (U) Net Equity Ownership is the value of the part of the business that black shareholders own, less any outstanding financial obligations that financed the purchase of shares, as a percentage of the current value of the company. The recognition of Net Equity Ownership is according to a complex formula proscribed in Code 100 that assumes a gradual increase in net equity over a period of nine years.

¶18. (U) Ownership Fulfillment refers to any conditions that might prevent black shareholders from achieving full net equity ownership. The Ownership fulfillment point will not be awarded unless a measured firm has attained a score of 7 points on Net Equity Ownership in accordance with a formula proscribed in Code 100.

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